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THE TAXATION OF THE UNEARNED INCREMENT IN GERMANY.

SUMMARY.

Introduction, 83, 84.—The extent of application of the increment-tax in Germany: Kiautschou, Bavaria, Saxony, Cologne, Frankfort, other cities, 85-91.—General principles: object, allowances, exemptions, period of reckoning, rate, 91-100.—Objections: confiscation, compensation for losses, shifting through rise of rents, 100-106.—Appendix: text of the Cologne ordinance, 106-108.

THE theory of taxing the unearned increment had its origin in America. Its application is most due to Germany. Altho references to the principle are not lacking in the writings of non-American economists, it was none the less Henry George who brought out clearly the importance of taxing the growing value of land. Henry George's proposals, believed by his opponents to have no chance of application, have come to vigorous life in the bracing air of German tax methods. So marked has been the development in Germany during the last few years that we see a vista of possible great influence on the whole tax question of the future, and this not only for the taxation of land, but for the taxation of all chance gains (*Konjunkturgewinne*). It is not my task here to enter on a consideration of the principles underlying this sort of taxation. I am concerned mainly with describing the precise form and extent of its application in Germany. A few words will suffice as to the general economic grounds for resort to it.

It is now a commonplace that a tax is to be judged with reference not solely to its fiscal yield, but to its social effects and the attainment of justice in taxation. Cer-

tainly in Germany, as the official reports on the state laws and communal ordinances make plain, the social consequences of taxing the unearned increment have been primarily considered, tho doubtless fiscal results have not been disregarded. In the main the tax is expected to have a salutary effect on the evils which appear conspicuously in land problems. The exploitation of speculative and unearned gains had often proceeded in dangerous form, especially in large cities. The housing problem had appeared, in consequence of monopoly ownership of sites, in such pressing form as to be recognized on all sides as a most important social problem. It was agreed that all methods should be tried for solving it.

From this point of view we reach the decisive arguments for and against taxing the growing value of land. The question of the unearned increment has become conspicuous not only in theoretic debate, but in practical controversies. On this question economists have shaped their conclusions before coming to the special problem of this form of taxation. My own view, briefly stated, is that all land speculation is not harmful. Not infrequently it happens that great stretches of land are opened up by such speculation, and the owner must be admitted to have contributed something toward the rise in value. But in the immense majority of cases the great rise in the value of land, especially in the cities, is not brought about by the owner, and is quite unearned by him. It is society which brings it about through its activity and at its cost, whereas the existing land system causes the gain to enure to the owners. To bring about in this regard balancing of desert and earnings seems to me an equally important and honorable task in modern taxation.

I.

THE INTRODUCTION OF THE TAXATION OF THE UNEARNED INCREMENT IN GERMANY.

Germany more than other countries has sought and has applied in all of its legislation the principle of social justice, and was the first country to turn its attention to the application of this uncontested principle of taxation. Some credit is due to the courage that has been shown, for the new departure opens up new paths for the entire future of taxation. The first steps, venturesome as they were, have had unexpected success.

The first tentative step was taken in 1898 in the model colony of Kiautschou. It attracted little attention. Wide-spread interest was not aroused until in 1904-05, when the two cities of Frankfort and Cologne enacted highly significant ordinances for the taxation of the unearned increment. In the debates on these projects I took an active part as editor of the *Kölnische Zeitung*. The first scientific monograph on this problem was published by me in 1895.¹ Since then, a number of larger and smaller publications have followed, and the subject has been largely discussed in scientific periodicals and in the general press.²

¹ Under the title of *Die Werkzuwachssteuer: zur Praxis und Theorie*. Jena: Gustav Fischer.

² An exhaustive bibliography of the books and periodicals on this subject has not been compiled, altho the number of items has grown to considerable dimensions. Among the most important I mention the following: the opposing book of John Victor Bredt, *Der Wertzuwachs an Grundstücken und seine Besteuerung in Preussen* (Bruer und Co., Berlin, 1907); and the reply to this from the land reformer's point of view by Jacob H. Epstein, *Zur Verteidigung der Zuwachssteuer, Sociale Streitfragen*, Heft 33-34 (Bodenreform, Berlin). Other replies, tho with some qualifications, came from Dr. Pabst in several essays, among which I mention *Die Idee einer Besteuerung der Konjunkturgewinne an Grundstücken und Gebäuden* (*Volkswirtschaftliche Blätter*, 5 Jahrg., No. 3, Berlin, 5 Februar, 1906). Among the advocates of this form of taxation the following are to be noted: Robert Hallgarten, *Die kommunale Besteuerung des unverdienten Wertzuwachses in England*, *Münchener Volkswirtschaftliche Studien*, Band 32 (Stuttgart 1899); Baumeister und Jäger, *Die Zuwachssteuer* (Heft 18 der *Sozialen Streitfragen*); Wesselsky, *Die*

The only legislation which applies the principle to a whole country is that of Kiautschou. No one of the federal states of Germany has passed an act making obligatory the taxation of the increased value of land. But proposals are pending, and are likely soon to be pressed to enactment in Saxony, in Hessen, and in Bavaria, some of which make such taxation compulsory for the local bodies, while others make it permissible. One of the earliest movements in this direction took place in Bavaria, in which a motion was introduced in the Lower House as early as July, 1902, as follows:—

The government is requested to present a bill by which, in all communes whose population has increased within the last census period much more than the average (say five times the average), the State and the communes are to have a share of the increase in the naked value of land (unearned increment) when a transfer of ownership takes place; and this in such manner that each shall receive 10 per cent. of the increase. The bill is further to require the communes to use their share of the receipts mainly for the improvement of lodgings for the poorer classes, while the State's share is also to be used for beneficent purposes.

Beteiligung der Städte am Bodenwertzuwachs (Heft 23 der Socialen Streitfragen, 1905); von Schrenck, Zur Frage der kommunalen Wertzuwachssteuer, mit besonderer Beziehung auf Riga (Müllersche Buchdruckerei, Riga, 1907). There is also to be noted Karl Kumpmann, Die Wertzuwachssteuer (H. Laupp, Tübingen, 1907). The reports of the government officials on the various tax ordinances are also important, such as those in Kiautschou, Saxony, Hessen, Cologne, Essen, Berlin. Among articles in periodicals the following are to be noted M. Koppe, Ist die Wertzuwachssteuer überwälzbar? Finanz Archiv, Jahrg. 23, 1; Die Zuwachssteuer, Jahrbuch der Bodenreform, Band 2, Heft 1; Die zeitliche Begrenzung des steuerpflichtigen Wertzuwachses, Jahrbuch der Bodenreform, Band 2-3. Also Adickes, Besitzwechselsabgabe und Wertzuwachssteuer, Deutsche Juristenzeitung, 1 März, 1906; R. Ehlert, Zur Wertzuwachssteuerfrage, Conrads Jahrbucher für Nationalökonomie und Statistik, Band 32, Heft 3, September, 1906; Adolf Wagner, Zur Rechtfertigung der Zuwachssteuer, Jahrbuch der Bodenreform, Jahrgang 2; R. Brunhuber, Der Hessische Regierungsentwurf einer Zuwachssteuer, Jahrbuch der Bodenreform, Band 2, Heft 4. The file of the periodical Bodenreform (formerly the Volkstimme) is important throughout. Finally, chapters or sections in the general works on economics and taxation are to be noted, such as Adolf Wagner, Lehr- und Handbuch der politischen Oekonomie, Finanzwissenschaft; Kommunale Steuerfragen, Heft 15 der Schriften der Gesellschaft für soziale Reform; A. Damaschke, Aufgaben der Gemeindepolitik, Kapitel: die Zuwachsrente; Jäger, Dr. Eugen, Die Wohnungsfrage (Verlag der Germania, Berlin, 1903); R. Eberstadt, Die Spekulation im neuzeitlichen Städtebau (Jena, 1907).

Nothing has yet come of this motion in the way of legislation. None the less, it is probable that in the near future the second largest of the German states will put into operation some form of taxing the unearned increment.

In Saxony also, legislation may be expected at an early date. Its probable content is indicated by the bill which the government submitted on January 26, 1904. The more important provisions of this bill are as follows:—

SECTION 53. In all communes having a population of more than 10,000 an increment-tax proportioned to the increase in value is to be paid by the transferrer in case of change in ownership of unimproved (*unbebaut*) land.¹

Under exceptional local conditions the levy of an increment-tax may be required by the supervising authorities in communes of less than 10,000 inhabitants. This levy is to take place if the commune may be regarded as a suburb or if an unusual increase of population has taken place in it.

SECTION 57. The amount of the increment-tax shall be:—

If the increase of value is 5 to 20 per cent. of the purchase value [*Erwerbswert*], at least 5 per cent. of the increase.

If the increase of value is 20 to 30 per cent. of the purchase value, at least 10 per cent. of the increase.

If the increase of value is 30 to 40 per cent. of the purchase value, at least 15 per cent. of the increase.

If the increase of value is 40 to 50 per cent. of the purchase value, at least 20 per cent. of the increase.

If the increase of value is over 50 per cent. of the purchase value, at least 25 per cent. of the increase.

If the increase in value is less than 5 per cent., there shall be no increment-tax.

SECTION 58. The purchase value shall be that value which the land has for its actual utilization on the part of the seller, or, if there is no actual utilization, such value as it would have under appropriate agricultural use.

The bill submitted by the government of Hesse has

¹ "Increment-tax" is used as the most convenient version of *Zuwachsteuer*, and "improved" and "unimproved" land for *bebaut* and *unbebaut*.—EDITOR.

already been accepted by the second chamber, but the consent of the first chamber is still lacking because of some points of minor importance. This bill simply establishes certain regulations under which the local bodies are at liberty to establish an increment-tax within the limits set down in the regulations. No permission of this sort is necessary in Prussia, since its existing legislation on local taxation already gives the communes complete freedom as to the levying of increment-taxes. In recent years, however, Prussia has gone further, and has given this permission not only to the communes, but to the circles (*Kreise*). In the debates upon the act of 1906 containing this provision, all parties in the Prussian House of Representatives showed their sympathy with the principle. This general feeling has already resulted in legislation in a number of circles, for instance in Teltow, where the building of a canal has caused large advances in the value of realty. Blumenthal has not only established an increment-tax for the circle, but has recommended to its communes a normal statute for a communal increment-tax, of which all the thirty-nine communes in this circle have made actual use.

None the less, the main field has been in the cities and in the urban communes. Frankfort and Cologne, which took the lead in 1904 and 1905 respectively, have been followed by a considerable array, in which we find not only the names of our great cities, but also those of moderate and small towns. Among the large cities there are, in addition to Frankfort and Cologne, Berlin and Breslau. Among those of moderate size are Gelsenkirchen, Essen, Dortmund, Hanau, Pankow, Weissensee, Paderborn, Gross-Lichterfelde, Marburg, Neuss, Jena, Osnabruck, Rudesheim, Kiel, and many others.

As practical examples of the technical steps in this legislation, which vary somewhat in each individual case,

we may select Berlin, Dortmund, and Cologne. The tax ordinances of these three cities suffice to indicate the lines upon which actual legislation is proceeding. The Cologne ordinance, whose text is given in full in the appendix, still shows a somewhat primitive form. The ordinance now pending in Berlin represents a compromise. Its main paragraph, which was presented by the magistrate of Berlin on January 11, 1906, to the municipal legislature, reads as follows:—

SECTION 7. In addition to the tax stated in Section 1 [transfer tax, *Umsatzsteuer*] an increment-tax shall be levied in case the present purchase price or market value of the land shall exceed by 10 per cent. the price or value at the last change in ownership, regard being had to the allowances stated in Section 9. For the levy of this additional tax it is immaterial whether the last preceding change in ownership has taken place before or after this ordinance goes into effect.

SECTION 8. The amount of the increment-tax shall be as follows:

5 per cent. of the increase in value, if this increase in value is more than 10 and up to 20 per cent.

6 per cent. of the increase in value, if this increase in value is more than 20 and up to 30 per cent.

7 per cent. of the increase in value, if this increase in value is more than 30 and up to 40 per cent.

8 per cent. of the increase in value, if this increase in value is more than 40 and up to 50 per cent.

9 per cent. of the increase in value, if this increase in value is more than 50 and up to 60 per cent.

And so on, 1 per cent. of the increase in value up to a maximum of 20 per cent.

For improved sites these rates shall be levied only if five years at most have passed between the last preceding and the current change in ownership. If more than five years and less than ten have elapsed, two-thirds of these rates shall be levied; if more than ten years have elapsed, one-third.

For unimproved sites the increment-tax shall be two-thirds of these rates if more than ten years and less than twenty have elapsed

since the last preceding change in ownership, and one-third if more than twenty years have elapsed. If the earlier purchase price or market value cannot be ascertained, then supplements to the present selling price shall take the place of the increment-tax. These supplements shall, for improved sites, be:—

After 10 @ 20 years,	1 per cent.
“ 20 “ 30 “	1½ “
“ 30 “ 40 “	2 “
“ over 40 “	2½ “

For unimproved sites:—

After 10 @ 20 years,	1 per cent.
“ 20 “ 30 “	2 “
“ 30 “ 40 “	3 “
“ over 40 “	4 “

SECTION 9. In ascertaining the increase in value taxable under Section 8, the base shall be the former purchase price, but to this are to be added the following:—

1. All expenses for permanent improvement of the land, including expenses for building streets and for connections with sewers. Expenses for remodelling or improvements are not to be taken into account, so far as covered by insurance payments.

2. In case of unimproved sites, which the transferrer has not himself used for agricultural or manufacturing purposes, 4 per cent. interest on the preceding purchase price, less all receipts. Where land has been given without compensation for streets or public places, the whole purchase price remains attributable to the remaining land, and in case of division is to be attributed to the several parcels. No other additions are permissible. Any difference between the previous purchase price, supplemented by the allowances herein provided, and the present selling value, is to be regarded as an increase of value.

After a discussion which lasted for more than a year, the municipal assembly on March 20, 1907, by a vote of 65 to 54, adopted the following general statement of principle: “In addition to the transfer tax an increment-tax shall be levied if the existing purchase price or market

value of a piece of land exceeds by more than 10 per cent. the price or value at the last preceding change in ownership, account being taken of the allowances stated in Section 9." The detailed elaboration of this measure was then referred to a committee, which will have not inconsiderable difficulties to overcome before the measure is ready for final enactment.¹

The model of a fully developed tax is found in Dortmund. In this, the last specific example which I shall describe, there is a carefully considered shading of the tax according to the elapsed length of time. An increment-tax is levied whenever an increase of value of at least 10 per cent. has taken place since the last preceding transfer, with due allowance for improvements and the like. The increment-tax varies from 3 to 15 per cent., according to the amount of the increase in value. The ordinance then proceeds:—

In case of transfer of improved land the tax rates herein mentioned are levied in full only if less than six years have elapsed since the purchase of the real estate. After ownership through six full years, the tax on such improved property is diminished by 10 per cent. of its amount; after seven years, by 20 per cent.; and so on by 10 per cent. more for each completed year of ownership, so that after fifteen years of ownership no increment-tax will be paid on the transfer of such land.

If the previous purchase price of unimproved land cannot be ascertained, its market value at the time of previous acquisition takes the place of purchase price in the assessment of the increment-tax. This market price is to be determined by the tax authorities of the commune.

II. GENERAL PRINCIPLES OF THE INCREMENT-TAX.

It will be seen that these tax systems vary not a little, partly on account of variations in local needs and circum-

¹Since this article was put in type, we learn that on September 26 the project for an increment-tax in Berlin was defeated.

stances. Herein lies a great advantage of this form of taxation. None the less certain traits appear in all of them, and the consideration of these lends itself to systematic deductive exposition.

I would divide the increment-tax into two classes, presenting essential differences, direct and indirect. The direct increment-tax bears upon the periodic increase in the value of land. It is immaterial whether the increment appears in the form of an increase of yield or of rent, whether through transition from agricultural or building use, or through the discovery of mines, springs, and the like. In all these cases there is occasion for a direct periodic tax to be levied one, two, or more years.

The second class, the indirect increment-tax, connects itself with some specified event, a transfer of title, an inheritance, or the like. Change of ownership here is the decisive element, and the tax is levied with respect both to increment and transfer.

In German practise the tax system of our dependency Kiautschou presents an example of direct increment taxation. The tax is levied at the rate of $33\frac{1}{3}$ per cent. after the elapse of each twenty-five years. But this case, interesting as it is, stands alone. Hence a systematic exposition may be confined to the indirect class. This I shall undertake as to its object, date of reckoning, rate, and the like.

Object.—The object upon which the increment-tax is levied is the unearned increase of value of real estate during a specified period. This is, in other words, the difference between the present purchase price and that which was paid at the time of the last change of ownership. In reckoning this difference, account is to be taken of sundry expenses of the owner's, of which more in detail will be said presently.

In place of the purchase price, the market value of the

property at the time is reckoned, if this latter is higher than the purchase price (for example, in Frankfort, Gelsenkirchen, Weissensee, and in the Berlin project). The market value is also reckoned, during the first stages of the tax, if the increase of value is calculated from a specific date and not from the date of last transfer. The taxable increment is to be diminished by allowances for improvements or other items. The most important allowances are, as to improved realty, the expenses for rebuilding and for additions; as to unimproved realty, loss of interest; as to both improved and unimproved, some expenses connected with change in ownership. In detail these allowances are commonly specified as follows:—

1. All expenses for permanent improvement of the property, especially for additions or rebuilding, provided these have not been met out of insurance receipts. Expenses for repairs and the like may not be deducted, since these serve not to increase the value of the property, but only to maintain it.

2. Expenses for street-building and for sewer connections.

3. Expenses resulting from the mere change in ownership, such as stamp taxes, registry and legal fees, transfer taxes, and the like. These deductions are, however, not allowed in all the tax ordinances. Where this allowance is provided for, it is usually by way of lump sum or general allowance,—sometimes a general 5 per cent. allowance, sometimes 3 per cent., and sometimes 3 per cent. for unimproved land and 5 per cent. for improved.

4. In most ordinances, increase in value due to natural constituents of the land—for instance, from quarries, mines, springs—is not reckoned as part of the increment. This allowance does not seem sound as a matter of principle, since there is here an unearned increment quite as much as in the cases usually taxable.

5. Deduction is commonly permitted for the amount which the preceding possessor has lost in case he came into possession of the property through public sale under mortgage proceedings and incurred loss through failure to secure the amount due under his mortgage; interest being also reckoned.

6. The allowances above mentioned are made in all cases for improved as well as for unimproved land. Loss of interest is allowed for unimproved land only. This loss of interest is usually reckoned at a specified rate,—4 per cent. at Cologne, Gross-Lichterfelde, $4\frac{1}{2}$ per cent. at Weissensee, 5 per cent. at Essen. The rate, whatever it be, is allowed upon the purchase price at the last preceding transfer, but with deduction of all receipts during the intervening period, as from agricultural use, storage, and the like. It is reckoned from the time when the preceding purchase price has been paid, or has become subject to interest, up to the date of the concluded bargain for present sale. Compound interest is not allowed. Some communes allow for loss of interest only if the seller has not himself used the land for agricultural or industrial purposes. If the seller has so used it, Frankfort permits deduction for expense of repair and maintenance, these being again offset by actual receipts.

7. There are certain exemptions, and these of two kinds. First, some kinds of transfer give rise to no tax; thus, transfers by inheritance, judiciary sale, donations between ascendants and descendants. Second, certain increases of value are exempted. Kiautschou alone taxes every increase of value, however slight. The first draft at Cologne also levied a tax uniform (15 per cent.) on all increments from 0 to 30 per cent. The Saxon proposal levies the tax when the increase in value is at least 5 per cent. The typical provision has come to be that the increase in value must exceed 10 per cent. before an increment-

tax is levied (for example, in Cologne, Dortmund, Berlin, and Hessen). Gelsenkirchen and Essen begin with 20 per cent. Frankfort goes farthest, exempting an increment of 30 per cent. and taxing only increase in value above this proportion. Some local considerations may be decisive in this place or that, but on the whole it may be said that exemption is carried too far. On the other hand, it is to be admitted that the taxation of absolutely every increase may bring injustice. An exemption of 5 per cent. of the increase would seem to suffice to prevent injustice. An important point is the extent and nature of the difference made between improved and unimproved real property. My own views on this are as follows: the increase in value represents a completely unearned increment as a rule only in case of unimproved land, which the owner keeps idle in available urban districts, and which rises in value, year after year, without any action on his part. In case of improved land the owner not infrequently contributes, or earns something. To make allowance for this the tax ordinances, as I have just stated, usually exempt part of the increase in value. This procedure, doubtless, has the desired effect. Consistency requires that in the case of unimproved land no such exemption should be made, certainly none exceeding 5 per cent. An exemption of 10 per cent. suffices to prevent the taxation of that increase of value in buildings which is due to the owner's action. No general exemption of improved property can be justified. A tradesman by developing his business may raise the value of the premises he occupies. This will show itself in the higher letting value of the premises and of the good will of the business. There can be but an infinitesimally small number of cases in which an allowance of 10 per cent. increase in value will not fairly reward such activity. In the immense majority of cases the higher value of im-

proved property is due to the general advance of the community. It is obviously untenable to ask an exemption in case of improved property merely because its increase in value is slight; and at all events a general exemption of 10 per cent. suffices to prevent any injustice on this score.

The existing tax systems and proposals may be differentiated according as they treat improved or unimproved property precisely alike or make more or less important distinctions between them. Those which treat the two precisely alike are open to the objection that unimproved land is put in a better position than improved land, since allowance is made for interest for the former. On principle there can be no doubt that the increase in value of vacant land is a peculiarly fit subject for taxation, whereas in the case of improved land some allowances should fairly be made, tho by no means going so far as to exempt it entirely. Two examples will suffice to show in what manner the treatment of improved and unimproved land in fact differs. The Berlin project provides, as to improved land, that the increment-tax shall be levied only if a period of at least five years has taken place between the preceding and the present transfer. If the interval is between five and ten years, the tax is imposed at two-thirds of the normal rates; if the period is above ten years, at one-third. In case of unimproved land this moderation of the normal rates takes place only if longer periods have elapsed.¹ Dortmund has established a regular descending scale for its increment-tax, but this for improved realty only, the scale being so arranged that after fifteen years the increment-tax entirely disappears. No such arrangement is made in Dortmund for unimproved real estate.

On the whole, there is a tendency to treat improved

¹ See the text of the Berlin proposal, above, p. 89.

property more favorably than unimproved. In the most extreme cases this is carried so far as to exempt entirely improved property. With growing experience in this form of taxation, more refined discrimination appears. In my judgment the best plan is to levy the tax at the same rate for a specified period on both improved and unimproved land, after a lapse of this period to make the tax on improved land one-half, and then to diminish it in regular progression with the further lapse of time.

Period for which the Taxable Increment is Reckoned. Since the increment tax proposes to reach the increase in value between the last preceding purchase price and the present price, the date for reckoning this increase in value must, ordinarily be that of the last preceding transfer of ownership. This is the normal case, commonly provided for in the tax ordinances. The last preceding transfer, however, may have taken place long ago, and then difficulties will arise. Thus there may have been a general change in the value of money, such as has taken place since the beginning and the middle of the nineteenth century. Again, the purchase price at the last preceding transfer may be difficult to ascertain, and the allowances for improvement and the like may be still more difficult to ascertain. These difficulties are met in various ways. Sometimes, when the period elapsed since the last transfer exceeds some decades, there is complete exemption. Sometimes a simple percentage of the present price is assessed as a roughly equitable increment-tax. Sometimes there are special provisions for the period of transition. As to the future, the actual increase in value is always made the basis of the tax, but for the period of the first introduction there is more or less modification. Some of the provisions for the period of transition are:—

1. (a) On the first transfer after the tax goes into effect, the increment-tax is reckoned on the basis of a market

value for whose ascertainment the tax ordinance makes provisions.

(b) If the last preceding purchase price cannot be ascertained or if there has been a transfer without a sale (inheritance or donation), the increment-tax is based upon the market value at the time of the last change in ownership.

2. Sometimes a fixed date is named from which the increase in value is reckoned; sometimes again a specified period (so many years before the current change in ownership) underlies the tax.

3. Sometimes the past is entirely disregarded and only that increase in value is subject to taxation which takes place after the tax goes into effect,—the future increment only. Such, for instance, has been the decision in Cologne. The tax is based upon the increase in value over market value on April 1, 1905, the date when the tax went into effect. Obviously, this makes the tax at the outset financially barren. It leaves untaxed, moreover, some of the most important cases of increase. The practical effect is of course, as one of the magistrates said, that at the beginning we have rather a theoretic formulation than tax. It is in my judgment indispensable to hold to some taxation of the already accrued increment.

The Tax Rate.—The rate at which the tax shall be assessed is a simpler matter, resting largely upon considerations of expediency. As a matter of principle, it deserves to be noted that the modern idea of progression almost always shows its influence. The earliest tax, that of Kiautschou, it is true, fixed a level rate of $33\frac{1}{3}$ per cent. But all other systems tax a large increase of value at a higher rate than smaller ones. The progression rests, of course, not upon the absolute increase in value, but upon the per cent. of the increase in value. This progression proceeds in two ways. The greater the percentage increase, the

higher the tax; and the more rapidly that increase in value has taken place, the more is a higher tax justified. He who captures a chance gain after a short interval may fairly be called upon to pay more than he who has had to wait some time.

In the more recent tax ordinances of Germany the tax begins after a certain percentage has been exempted. We find then minimum rates from 3 to 10 per cent., maximum rates from 15 to 30 per cent. Sometimes the progression is slow: thus in Cologne the tax rate rises 1 per cent. with every 10 per cent. increase in value. Sometimes it rises rapidly, for instance in Saxony, where the tax increases 5 per cent. with every 10 per cent. increase in value. I believe that a minimum rate of 3 per cent., where the increase in value is between 10 and 20 per cent., is too low. Even 5 per cent. is too low. The initial rate should be at least 10 per cent. Maximum rates of 15, 20, 25 per cent. do not seem to be high enough, especially when there are advances in value of as much as 100 per cent.; for in these cases there can be no pretense that the increment is earned. The first proposal in Cologne had made the maximum rate 35 per cent. In Gelsenkirchen it is 30 per cent. Kiautschou, as we have seen, has 33 per cent. The theoretic writers also lean to higher rates. Jäger (*Wohnungsfrage*, vol. ii. p. 190) remarks that, "in order to be effective, the increment-tax on large properties should be at least $33\frac{1}{3}$, or 50 per cent. of the value. If the increase in value is really the result in the main of the industrial activity of the community, then the community may fairly demand from the owner a share as large as this. He still retains one-half or two-thirds of the increase, and this without any exertion of his own." I believe that the tax should begin with 10 per cent., should rise rapidly to 35 per cent. (say for an increase of value of 50 per cent.), while a tax of 50 per cent. is entirely reasonable where the increase in value is 100 per cent. or more.

Sundry provisions of detail may be noted. A transfer giving occasion for the levy of the tax is ordinarily a sale, exchange, or gift. Inheritance or appropriation under eminent domain are seldom made taxable. The taxpayer is usually the seller, he being the person who pockets the gain. Sometimes, however, the buyer is made conditionally liable in case the seller fails to pay,—a provision which is quite without justification. The method of assessment is different according to local circumstances, and presents considerable variation.

III. OBJECTIONS TO THE INCREMENT-TAX.

I proceed now to a consideration of the objections to this form of taxation. I shall pay no attention to superficial phrases, such as confiscation, socialism, and the like. Three objections seem to deserve serious consideration. The first is that the increase in the value of land is usually earned, only in rare cases completely unearned. The second is that if the increase in value is to be taxed, a decline in value should receive compensation; more particularly that, where the same individual incurs a loss in selling one piece of property, this is to be deducted from any gain secured by him on another piece of property. Finally, that the tax will be shifted from the seller to the buyer; it will raise the value of land, and so impede the progress of land reform. I will consider these objections in order. I shall not, however, enter on the question whether real property already bears a sufficient burden of taxation. So far as Germany is concerned, this, as a rule, is by no means the case.

(1) The question whether a given income is "earned," of course, arises in regard to the general return on capital. But even he who finds in capital and in capitalist management a helpful factor in industry, and is not disposed to do

away with the return to capital, must grant that the situation is different in the case of land. Land value represents not only return on capital, but a ground rent which must be paid by the rest of the population to the owner of the land. And further, no careful thinker can deny that in the case of land, more than in any other form of ownership, great values are created by the activity of the community or by mere chance. Hence the "unearned" increment and the justice of its taxation. Moreover, it is to be borne in mind that this form of taxation does not propose to wipe out by taxation the increase of value: it is simply to be taxed. After an exemption of 10 per cent., only certain percentages of the increase in value are to be levied, varying in detail as has been explained in the preceding pages.

The increment-tax, it must be remembered, differs from existing land taxes in that it is levied not upon the ownership of land as such. It bears on a newly accruing income; and herein it has an advantage over other taxes, levied as they commonly are without regard to the character of the incomes accruing.

Candid consideration brings to light no objections to the increment-tax on this score, but only reasons in favor of it. It is consistent with the principle of ability, since it is levied only on realized gains. It is consistent with the *quid pro quo* principle, since the community only takes some fraction of a gain to which it has itself contributed. It stands for a moderate and just profit-sharing on the part of the community. On the other hand, it levies no burden on the tax-payer, only lessens an existing and largely unearned gain.

(2) As to the second objection, that taxation of gains should be accompanied by compensation for losses, there should be a distinction as to whether loss in value has been directly due to public action. If, for example, the build-

ing of elevated railways or suspension railways lowers the value of adjoining houses and land, the public is under obligation to compensate for this loss in value. The question is not so easy to answer, if the change in value is due simply to the removal or remodelling of bridges, public markets, theatres. Since there was not at the outset any right to having these establishments in one's neighborhood, any claim for compensation is to be rejected. Compensation for any and all losses in value certainly has no just basis. Quite apart from the possibility of fraud, it is obvious that no one would advocate compensation in case of losses on property other than land. The mere payment of ordinary taxes on land gives rise to no claim; taxes are levied on other property also.

(3) The most important objection is the third,—that the tax will be shifted from seller to buyer, and will serve not to lower the value of land, but to increase it.

The usual theoretic answer to this objection rests upon the *a priori* theorem of the earlier writers upon rent, that a tax upon rent falls solely upon the land-owner and cannot be shifted. This theorem may be valid, and doubtless was so at the time when it was set up. At that time there was still enough free land or at least very cheap land. There were still no great cities. To-day the case is otherwise. The land-owners in the cities have a monopoly,—a great monopoly of sites. Under these circumstances, if the owner has as unqualified control over his site as he has hitherto had, a shifting of the tax is entirely possible. The amount of the tax may be added to the price, and rents may rise correspondingly. In our times, however, other factors enter which may serve to prevent this outcome. The object of modern land policy is to destroy the monopoly of the site-owners. The conditions of land ownership, moreover, facilitate this outcome. The owner is often not in a strong position. He is apt to be but a nominal owner,

having a bare title subject to a mortgage. The corollary is obvious, that a cash tax, levied in case of sale of land bought on speculation, where the next purchaser is himself likely to give a mortgage, will serve to check speculation. It is characteristic that in one of the debates at Cologne it was made an objection against the increment-tax that the seller of land in most cases did not receive his price in cash. This circumstance indicates precisely one of the strong advantages of the tax. It serves to check reckless speculation.

Now every check on land speculation tends to lower prices. This effect is the greater, the higher the percentage of the tax and the greater the amount of cash which consequently must be furnished. The increment-tax is the specific remedy against land speculation. While the details necessarily vary according to the special circumstances of the several cities, the value-raising effect of the ordinary taxes on monopoly real estate is paralyzed by it under the modern conditions of speculative buying. It is obvious that an increment-tax, since it opens the prospect that a large part of increased gains will be appropriated by the community, stands in the way of any artificial rise in rents and in real estate value. A substantial and rapidly progressive tax of this sort hence tends to keep down the price of land.

None the less, something more is to be said. It is to be admitted that sometimes there is such a demand for land that there is a possibility of shifting the increment-tax to the ground rent and so causing great economic evils. This possibility must not be neglected by the warmest advocate of the tax, the less so because the means of obviating it are at hand. These are to be found in a firm policy of land reform. The increment-tax has been effective in keeping land values down precisely where it has been accompanied by action in this direction.

My conclusion, therefore, is that no tenable objection can be maintained against the increment-tax. On the contrary, its effects, as I will now proceed to show, are highly advantageous. These effects may again be examined under three heads,—as to taxation, financial convenience, and the land reform.

So far as taxation is concerned, I have already said enough as to the justice of the levy and of its happy combination of financial yield and social justification. One further point, however, should be noted. We have nowadays in Germany not only the usual land taxes (levied upon the income or the capital value, *gemeiner Wert*), but we have also well-nigh universally the transfer tax. The transfer tax yields a substantial revenue, but often brings hardship or injustice, and in declining cities or districts presents grave difficulties. This tax should be brought to the minimum. The principle of the increment-tax, by which only the gain on a transfer of realty is taxed, is the sound one. In it, therefore, we should find a substitute for the transfer tax. This is often expressly aimed at. It is the principle accepted in Cologne, where the purely financial transfer tax is to be replaced in time by the social increment-tax. To this there is to be added the further consideration that the increment-tax more than any other can be adapted flexibly to local needs, being readily adjustable either with a progressive or degressive scale of rates.

The financial outcome, which we have next to consider, must be admitted to be so far inconsiderable. I will not undertake any detailed statistics, and will only mention that the yield has often exceeded the amounts estimated. The proceeds of the tax, it is often maintained, should be used for the purpose of improving the housing conditions of the lower classes. Some provision of this sort has been sought to be incorporated, for example in Bavarian statutes. Much is to be said in favor of this prin-

ciple. It seems, however, to be somewhat one-sided, not granting to the community, as a whole, what the community after all has created. Moreover, it is conceivable that the yield may be greater than can be advantageously used for such purposes. There is ground for caution, therefore, in pressing the principle too far, more particularly as it may prove an obstacle to the actual imposition of the tax in the communes.

It should also be noted, on the financial side, that the yield of taxes of this sort is likely to be variable. No doubt the yield is likely to increase on the whole, but not at any regular rate. The local bodies and the State must take this probability of fluctuation into account, and must make use only of an average ascertainable over a longer period or accumulate the funds for some specified purpose.

Finally, we have to consider the effects upon land reform. All taxation of sites, especially of site gains, works toward such reform. I have already indicated why the increment tax will serve to check speculation and to lessen the price of land. Every tax upon ground rent tends to lessen the price of land: the increment-tax is further beneficial in its effect on the ways of buying and selling land. According as the earlier or later stages of ownership are more heavily affected, this tax may serve to stimulate or to deaden the market for land.

Owners and tenants of land are the natural opponents of this form of taxation, and in Germany their judgment is severely against it. Yet it is to be said that public opinion in general is highly favorable. Just as the principle of taxation on the basis of capital value has swept over Germany, so we find an unceasing progress in the application of the increment-tax. This simple fact proves the strength of the ideas underlying it. We may hope that the confident expectations entertained in Germany will be fulfilled, and that the experience of Germany may

lead other countries also to give this problem practical attention.

R. BRUNHUBER.

COLOGNE, GERMANY.

APPENDIX.

THE INCREMENT-TAX OF COLOGNE.

ORDINANCE FOR THE LEVY OF A TRANSFER- AND INCREMENT-TAX IN
THE CITY OF COLOGNE, OF $\frac{23 \text{ FEBRUARY}}{6 \text{ APRIL}}$, 1905.

SECTION 1. Whoever acquires, by sale or by compulsory auction proceedings, a piece of realty, improved or unimproved, lying within the city limits, shall pay a communal tax (transfer-tax) of 2 per cent. of the value of the acquired realty.

If the seller has paid an increment-tax (as required in Sections 3 to 6), the purchaser is entitled to deduct the amount paid for increment-tax from the transfer-tax to be paid by him; but the amount so deducted shall not exceed 50 per cent. of the transfer-tax chargeable.

SECTION 2. Transfer of property under eminent domain is to be regarded as a sale. But a transfer resting directly on inheritance is not to be regarded as a sale.

The value of the property shall be the market value at the time of acquisition. If in the legal steps attending the acquisition a specific price has been agreed upon, that price shall be the basis of the tax, provided that the market value at the time of acquisition is not higher than this price.

SECTION 3. In addition to the tax provided for in Section 1, and under the same transfers of ownership of improved or unimproved realty, a separate tax (increment-tax) shall be levied upon the seller as provided in the sections following.

SECTION 4. The increment-tax shall be reckoned on the basis of the accruing increase of value.

This increase of value is the difference between the last purchase price plus the allowances described in Section 5 and the present selling price less the deductions permitted in Section 5.

SECTION 5. To the last purchase price there are to be added:—

- (a) In case of unimproved realty, interest at 4 per cent. on the last purchase price from the date of the payment or the date of putting at interest of that price to the time of the current transfer, but without compound interest;
- (b) All proved expenses for improvement, including expenses for street building as well as expenses for additions and re-

construction in buildings, including interest and architects' commission, provided that these expenses have not been met out of insurance payments. Expenses for street building are to be reckoned with 4 per cent. interest from the date of their payment, but without compound interest;

- (c) 5 per cent. of the last purchase price, as compensation for expenses of purchase (stamps, transfer taxes, legal fees, and the like).

If separate parcels of a piece of realty which forms a geographical and industrial entity are transferred by separate transactions of the transferrer or his heirs, the increase in value of any single parcel is to be diminished by any loss in value on the transfer of other parcels; provided, however, that the loss-bringing transfer has taken place simultaneously or within the preceding three years.

SECTION 6. An increase in value of 10 per cent. is, in all cases, exempt from taxation.

For the rate of taxation the whole increase in value, including any part which may not be taxable, is to be taken into account. The increase in value exceeding 10 per cent. is to be taxed as follows:—

10 per cent. on an increase in value between 10 and 20 per cent. inclusive.

11	"	"	"	20	"	30	"	"
12	"	"	"	30	"	40	"	"
13	"	"	"	40	"	50	"	"
14	"	"	"	50	"	60	"	"
15	"	"	"	60	"	70	"	"
16	"	"	"	70	"	80	"	"
17	"	"	"	80	"	90	"	"
18	"	"	"	90	"	100	"	"
19	"	"	"	100	"	110	"	"
20	"	"	"	110	"	120	"	"
21	"	"	"	120	"	130	"	"
22	"	"	"	130	"	140	"	"
23	"	"	"	140	"	150	"	"
24	"	"	"	150	"	160	"	"
25	"	"	over	160				

These rates shall be levied only if five years at most have passed between the preceding transfer and the present transfer. If the period exceeds five years, and at most is ten, two-thirds of these rates shall be levied; if the period exceeds ten years, one-third.

If neither the purchase price nor the market value of unimproved land at the time of the present transfer exceeds 0.60 marks for the square meter, no increment-tax shall be paid.¹

¹ 0.60 marks per square meter is roughly 1½ cents. per square foot.

SECTION 7. The taxes provided for in Sections 1 to 3 shall not be levied:—

- (1) In case of auction sale under legal procedure, if the acquirer of the realty can be proved as owner, mortgage creditor, previous possessor, or as security, to have been able to avoid loss only by undertaking the purchase.
- (2) In case of *Zusammenlegungen*.¹
- (3) In case of *Umlegungen*.¹
4. In case of acquisitions on the part of the Treasury, the German Empire, and the Prussian State, in so far as in these cases no stamp tax is required under Section 4, E. of the Prussian Stamp Tax Law of July 31, 1895.
5. In case of transfer by way of gift between ascendants or descendants or between married persons.
6. In case of transfers which take place between heirs or devisees or married couples, or successors of such, for division of real property belonging to them jointly.
7. In case of other division of joint property between the owners, in so far as the participants receive no more than the value of their previous share in the property divided.
8. In case of transfers from heirs to the devisee of property devised by will.

SECTION 8. The tax provided for in Section 1 shall be paid by the purchaser, that described in Section 3 by the transferrer.

(Sections 9 to 13 are not material.)

SECTION 14. For the first transfer of property after the date when this ordinance goes into effect, the following special provisions shall hold in regard to the increment-tax —

The market value of the realty on April 1, 1905, shall be reckoned in place of the last purchase price, including the allowances of Section 5.

The market price shall be separately established for each parcel of realty.

SECTION 15. In case the yield of the increment-tax at the close of any financial year exceeds 400,000 marks, the transfer-tax for the following year shall be lessened by one-half of 1 per cent; in case the yield exceeds 800,000 marks, the transfer-tax shall be lessened by 1 per cent.

SECTION 16. This ordinance goes into effect on the date of publication, and expires on April 1, 1910

¹ These phrases refer to compulsory redistributions of land under legal process.